



UNIVERSITI PUTRA MALAYSIA

**THE IMPACT OF TYPES OF ISSUES,
SECTORS, LIFESPAN AND DIFFERENT ECONOMIC
PERIODS ON THE SHORT -RUN AND LONG-
RUN PERFORMANCE OF IPOs**

AFIRUDDIN BIN TAPA

GSM 2003 15

**THE IMPACT OF TYPES OF ISSUES, SECTORS, LIFESPAN AND
DIFFERENT ECONOMIC PERIODS ON THE SHORT-RUN AND LONG-
RUN PERFORMANCE OF IPOs**

By

AFIRUDDIN BIN TAPA

Thesis Submitted to the Graduate School of Management, Universiti Putra Malaysia,
in Partial Fulfillment of the Requirements for the Degree of Master of Science

November 2003



To my wife, Nor Azita and daughter, Nur Anis Aishah for their patience, tolerance
and support.

Abstract of thesis presented to the Senate of Universiti Putra Malaysia in partial fulfillment of the requirements for the degree of Master of Science

**THE IMPACT OF TYPES OF ISSUES, SECTORS, LIFESPAN AND
DIFFERENT ECONOMIC PERIODS ON THE SHORT-RUN AND LONG-
RUN PERFORMANCE OF IPOs**

By

AFIRUDDIN BIN TAPA

November 2003

Chairman: Professor Shamsheer Mohamad Ramadili, Ph.D.

Faculty: Graduate School of Management

This study examines the performance of initial public offerings (IPOs) of 157 KLSE Main Board Companies for the period 1990 to 1999. The performance of the IPOs is analysed based on sample classification of types of issues, sectors in the Kuala Lumpur Stock Exchange (KLSE), the lifespan of a company and different economic conditions. Both the short-run and long-run performances were analysed.

This study documents an average first day initial return of 88.11%. This is consistent with previous studies which reported that most IPOs are generally underpriced on their first day of trading. Furthermore, the evidence shows that the average abnormal returns in the long-run are smaller than those in the short-run.

There is substantial variation in the performance of IPOs across sectors in the Main Board of the KLSE. The Property, Industrial Product and Construction sectors reported the highest initial returns (above 100%).

The finding shows a significant difference in the mean initial returns under different economic conditions. In the hot market, Malaysian IPOs recorded a higher return (127.96%) than in the cold market (27.04%).

With respect to lifespan, the number of years existing does not affect the level of initial return of the IPOs. There is no significant difference in initial returns among three types of issues namely public issues, offer for sale and hybrid of public issues and offer for sale. This finding is inconsistent with the documented evidence in the developed markets.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi sebahagian keperluan untuk ijazah Master Sains

PENCAPAIAN TERBITAN SAHAM BARU: BERDASARKAN KAEDAH TAWARAN, SEKTOR, JANGKA HAYAT SYARIKAT DAN KEADAAN EKONOMI YANG BERBEZA DI DALAM JANGKA PENDEK DAN JANGKA PANJANG.

Oleh

AFIRUDDIN BIN TAPA

November 2003

Pengerusi: Profesor Shamsheer Mohamad Ramadili, Ph.D.

Fakulti: Sekolah Pengajian Siswazah Pengurusan

Penyelidikan ini bertujuan untuk mengkaji pencapaian terbitan saham baru berdasarkan sampel sebanyak 157 buah syarikat yang disenaraikan di Papan Utama Bursa Saham Kuala Lumpur (BSKL) dari tahun 1990 hingga 1999. Pencapaian terbitan saham baru telah diklasifikasikan berdasarkan kaedah tawaran terbitan saham baru, sektor di BSKL, tempoh jangka hayat syarikat sebelum disenaraikan di bursa saham dan keadaan ekonomi yang berbeza. Pencapaian jangka pendek dan jangka panjang terbitan saham baru juga dikaji dalam kajian ini.

Hasil kajian menunjukkan pulangan purata yang diperolehi pada hari pertama penyenaraian ialah sebanyak 88.11%. Ini menunjukkan keputusan yang selari dengan keputusan kajian yang lepas di mana saham terbitan baru telah ditawarkan pada harga yang lebih rendah berbanding harga sebenarnya. Kajian ini juga menunjukkan pulangan jangka panjang terbitan saham baru adalah lebih rendah jika dibandingkan dengan pulangan jangka pendek.

Variasi pencapaian terbitan saham baru wujud di antara sektor-sektor di Papan Utama Bursa Saham Kuala Lumpur. Sektor Hartanah, Barangan Industri dan Pembinaan merupakan sektor yang memberi pulangan yang tertinggi (melebihi 100%).

Hasil kajian menunjukkan terdapat perbezaan terhadap pulangan purata pada hari pertama penyenaraian berdasarkan keadaan ekonomi yang berbeza. Dalam keadaan ekonomi yang menaik, terbitan saham baru Malaysia merekodkan pulangan yang lebih tinggi (127.96%) berbanding dalam keadaan ekonomi yang menurun (27.04%).

Berdasarkan jangka hayat sesebuah syarikat sebelum disenaraikan di bursa saham, kajian ini mendapati tempoh masa penubuhan sesebuah syarikat tidak mempengaruhi jumlah pulangan pada hari pertama penyenaraian terbitan saham baru. Kajian ini juga mendapati tiada sebarang perbezaan terhadap pulangan yang diperolehi secara purata pada hari pertama penyenaraian berdasarkan tiga kaedah tawaran semasa penyenaraian iaitu saham biasa, tawaran untuk jualan dan gabungan saham (saham biasa dan tawaran untuk jualan). Hasil kajian ini berbeza dengan keputusan kajian bagi pasaran yang sudah membangun.

Acknowledgement

In the name of Allah SWT, the Compassionate and the Merciful, to whom I owe the strength and sense of purpose that have enabled me to undertake this thesis, and without His blessing it would not have been completed.

First of all, I would like to extend my deepest appreciation to my supervisor and committee members, Prof. Dr. Shamsheer Mohamad Ramadili, Dr. Huson Johar Aliahmed and Dr. Taufiq Hassan for their invaluable guidance, constructive comments and advice throughout the preparation of this thesis.

Special thanks go to the KLSE Public Information Center staff who helped me with the data required for this thesis. I also would like to record my appreciation to the Universiti Utara Malaysia (UUM) for granting me study leave and scholarship to enable me to undertake the Master of Science Finance. To my friends, I am also indebted to them for their guidance, encouragement and great company.

I would like to express my deep appreciation to my mother, Hajjah Faredah Hashim and my father, Haji Tapa Abdullah, for their prayers, constant encouragement and support which will always be remembered but can never be repaid.

Last but not least, I would like to express my deepest indebtedness and gratitude to my wife, Nor Azita Md. Tajudin, for her understanding and encouragement, and lastly to my beloved daughter, Nur Anis Aishah who has given me an inspiration to complete this thesis.

I certify that an Examination Committee met on **25th August 2003** to conduct the final examination of **Afiruddin bin Tapa** on his **Master of Science** thesis entitled **“The Impact of Types of Issues, Sectors, Lifespan and Different Economic Periods on the Short-Run and Long-Run Performance of IPOs”** in accordance with Universiti Pertanian Malaysia (Higher Degree) Act 1980 and Universiti Pertanian Malaysia (Higher Degree) Regulations 1981. The Committee recommends that the candidate be awarded the relevant degree. Members of the Examination Committee are as follows:

Arfah Salleh, Ph.D.

Associate Profesor
Graduate School of Management
Universiti Putra Malaysia
(Chairman)

Annuar Md Nassir, Ph.D.

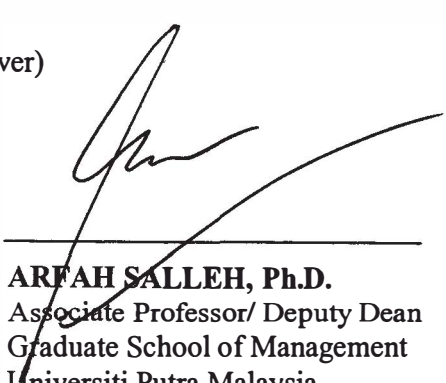
Professor
Faculty of Economics and Management
Universiti Putra Malaysia
(Internal Examiner)

M. Fazilah binti Abdul Samad, Ph.D.

Associate Professor
Faculty of Business and Accountancy
Universiti Malaya
(External Examiner)

Shamsher Mohamad Ramadili, Ph.D.

Professor
Graduate School of Management
Universiti Putra Malaysia
(Representative of Supervisory Committee/Observer)



ARFAH SALLEH, Ph.D.
Associate Professor/ Deputy Dean
Graduate School of Management
Universiti Putra Malaysia

Date: 26/1/04

This thesis submitted to the Senate of Universiti Putra Malaysia and has been accepted as partial fulfillment of the requirements for the degree of Master of Science. The members of the Supervisory Committee are as follows:

Shamsher Mohamad Ramadili, Ph.D.

Professor
Graduate School of Management
Universiti Putra Malaysia
(Chairman)

Huson Joher Aliahmed, Ph.D.

Lecturer
Faculty of Economics and Management
Universiti Putra Malaysia
(Member)

Taufiq Hassan, Ph.D.

Lecturer
Faculty of Economics and Management
Universiti Putra Malaysia
(Member)



HJ. ZAINAL ABIDIN KIDAM

Associate Professor/Dean
Graduate School Management
Universiti Putra Malaysia.

Date: 12/2/04

DECLARATION

I hereby declare that the thesis is based on my original work except for quotations and citations which have been duly acknowledged. I also declare that it has not been previously or concurrently submitted for any other degree at UPM or other institutions.



AFIRUDDIN TAPA

Date: 25/10/2003

Table of Contents

	Page
DEDICATION	i
ABSTRACT	ii
ABSTRAK	iv
ACKNOWLEDGEMENT	vi
APPROVAL SHEETS	vii
DECLARATION FORM	ix
TABLE OF CONTENTS	x
LIST OF TABLES	xiii
LIST OF FIGURES	xiv
GLOSSARY OF TERMS	xv

CHAPTER

1	INTRODUCTION	
	1.1 Background of the Study	1
	1.2 The Needs and Importance of IPOs	3
	1.3 The IPOs Process in Malaysia	4
	1.4 Method of New Issues	6
	1.5 Listing Requirements	8
	1.6 Percentage Contribution of IPOs to Capital Market	9
	1.7 Problem Statement	10
	1.8 Objectives of the Study	16
	1.9 Significant of the Study	17
	1.10 Organization of the Thesis	18
	1.11 Summary of the Chapter	19
2	THEORY AND LITERATURE REVIEW	
	2.1 Theory of IPC Underpricing	20
	2.1 Theoretical Framework	23
	2.3 Review of International evidence on IPOs	26
	2.4 Review of evidence of Malaysian IPOs	27
	2.5 Empirical evidence in other markets	31
	2.6 Summary of the Chapter	35



3	DATA AND METHODOLOGY	
3.1	Introduction	36
3.2	Data	36
3.3	Methodology	43
3.3.1	Measurement of Initial return	43
3.3.2	Method of Analysis for Company's Lifespan	46
3.3.3	Statistical Test	46
	T-Test	
	ANOVA	
3.4	Hypotheses	48
3.4.1	Market Adjusted Initial Return on the First Day	48
3.4.2	Market Adjusted Return for the	
	6 month (Short-run)	49
3.4.3	Market Adjusted Return for the	
	36 month (Long-run)	49
3.4.4	Performance of IPOs in the case of	
	Types of Issues	50
3.4.5	Performance of IPOs in the case	
	of Sectors in KLSE	50
3.4.6	Performance of IPOs in the case of	
	Lifespan of the Company	51
3.4.7	Performance of IPOs of the Different	
	Economic Periods	52
3.5	Summary of the Chapter	52
4	EMPIRICAL FINDINGS	
4.1	Introduction	54
4.2	Market Adjusted Initial Return on the First Day	55
4.3	Short-Run Performance of IPOs	56
4.4	Long-Run Performance of IPOs	58
4.5	Performance of IPOs based of Types of Issues	60
4.5.1	Short-Run Performance of IPOs based on	
	Types of Issues	63
4.5.2	Long-Run Performance of IPOs based on	
	Types of Issues	65
4.5.3	The Differences in Returns between	
	Types of Issues	66
4.6	Performance of IPOs based on Sectors in the Main	
	Board of the KLSE	67
4.6.1	Market adjusted Initial Returns by the Sectors	67
4.6.2	Short-Run Returns of IPOs by Sectors Specific	70
4.6.3	Long-Run Returns of IPOs by Sectors Specific	72
4.6.4	The differences in Mean Initial Returns between	
	two sector in the KLSE	74

4.7	Performance of IPOs based on Lifespan of the Company	76
4.7.1	The differences in the Mean Initial Returns between two Categories of Lifespan	77
4.8	The Performance of IPOs in Different Economic Periods	80
4.8.1	Short-Run Performance of IPOs in Hot and Cold Markets	83
4.8.2	Long-Run Performance of IPOs in Hot and Cold Markets	85
4.9	Performance of IPOs by Initial Returns	87
4.10	Summary of the Chapter	89
5	CONCLUSION AND RECOMMENDATIONS	
5.1	Introduction	90
5.2	Restatement of the Objectives	90
5.3	Summary of the Findings	91
5.4	Recommendations	94
5.5	Implication of the Findings	96
	REFERENCES	98
	APPENDICES	102
	VITA	122



LIST OF TABLES

Tables		Page
1.0	KLSE Listing Requirements	8
1.1	Percentage Contribution of IPOs to Malaysia's Capital Market	9
2.0	Summary of Previous Studies on the Short-Run Performance and Long-Run Performance of IPOs	26
3.0	Number of New Issues from 1990 to 1999 in KLSE	39
3.1	IPOs by Types of Issues: 1990-1999	41
3.2	IPOs based on the Sectors: 1990-1999	42
4.0	Average First Day Underpricing in Malaysia: 1990-1999	55
4.1	Short-Run Performance of IPOs Relative to Offer Price: 1990-1999	56
4.2	Long-Run Performance of IPOs Relative to Offer Prices: 1990-1999	58
4.3	T-test of Initial Returns by Types of Issues: 1990-1999	61
4.4	Short-Run Performance of IPOs based on Types of Issues : 1990-1999	63
4.5	Long-Run Performance of IPOs based on Types of Issues : 1990-1999	65
4.6	Test for the differences in Mean Initial Returns among the Types of New Issues	66
4.7	Sectorial Market Adjusted Initial Returns: 1990-1999	68
4.8	Short-Run Average Returns by Sectors Specific: 1990-1999	70
4.9	Long-Run Average Returns by Sectors Specific: 1990-1999	72
4.10	The differences in Mean Initial Returns between two Sectors: 1990-1999	74
4.11	Average Returns and Lifespan of Companies: 1990-1999	76
4.12	Test for the Differences in Mean Initial Returns of Companies' Lifespan	77
4.13	Market Adjusted Initial Returns in Hot and Cold Markets	80
4.14	Hot and Cold Markets: Short-Run Performance	83
4.15	Hot and Cold Markets: Long-Run Performance	85
4.16	IPOs categorized by Initial Returns (Short-Run):1999-1999	87
4.17	IPOs categorized by Initial Returns (Long-Run):1999-1999	87



LIST OF FIGURES

Figures		Page
3.0	Percentage of IPOs by Board of Listing: 1990-1999	39
3.1	IPOs by Three Types of Issues: 1990-1999	40
3.2	Number of IPOs by Sectors Specific: 1990-1999	42
4.0	Short-Run Performance of IPOs in the Main Board of the KLSE:1990-1999	56
4.1	Long-Run Performance of IPOs in the Main Board of the KLSE:1990-1999	58
4.2	Initial Returns by Types of Issues: 1990-1999	60
4.3	Sectorial Market Adjusted Initial Returns in the Main Board of the KLSE: 1990-1999	67
4.4	Hot and Cold Markets: Short-Run Performance	83
4.5	Hot and Cold Markets: Long-Run Performance	85

Glossary of Terms

IPOs	-	Initial Public Offerings
KLSE	-	Kuala Lumpur Stock Exchange
SC	-	Securities Commission
MITI	-	Ministry of International Trade and Industry
MAIR	-	Market Adjusted Initial Return
CI	-	Composite Index

Chapter 1

Introduction

1.1 Background of the Study

The performance of Initial Public Offerings (IPOs) has been a long standing issue among academicians, practitioners and researchers due to its strategic impact on investment decision. Extensive literature has been documented to understand the price behaviour of these offerings both in developed and developing markets. Generally, the findings of previous literature showed that IPOs recorded substantial gains on the first day of trading and provided excess return to the investors who initially subscribed the offers and then sold them immediately in the market.

Underpricing for new issues is a well-known phenomenon both in the developed and the developing markets such as Malaysia. This study aims at examining the primary market price performance of the underpricing of new issues or Initial Public Offerings (IPOs) in the Main Board of Kuala Lumpur Stock Exchange, during the period of 1990 to 1999. It focuses on four main areas of interest. Firstly, it studies into the performance of IPOs based on three types of issues: Public Issues, Offer for Sale and Hybrid of Public Issues and Offer for Sale. Secondly, focuses on the performance of IPOs based on the sectors in the KLSE namely, Finance, Consumer Products, Construction, Property, Trading and Services, Plantation, Technology and Industrial Product. Thirdly, it examines the

performance of IPOs based on their lifespan for a particular company before they are listed to ascertain whether their lifespan has any impact on the initial return of IPOs. Finally, the study examines the performance of IPOs under two different economic conditions namely hot and cold markets.

Numerous studies on similar issue have concluded that there are several explanations for the underpricing of IPOs. According to Rock (1986) and Beatty and Ritter (1986) underpricing of IPOs is the result of a winner's curse to uninformed investors caused by asymmetric information between the informed and the uninformed investors¹. The informed investors are assumed to have access to private information about the true value of new issues. Therefore, they will only subscribe to a new issue if the after-market price is expected to exceed the offer price. The uninformed investors on the other hand are assumed to subscribe to all new issues indiscriminately, and they will end up purchasing the overpriced or underpriced IPOs. Naturally, in order to avoid the uncertainty in the new issues the uninformed investors tend to stay out of the new issues market. However, in order to ensure that the offering is fully subscribed, the new issue has to be underpriced to entice the uninformed investors into the market.

Nevertheless, Allen and Faulhaber (1989) argued that asymmetric information causes quality firms to signal their quality by underpricing. In doing so, they expect to raise capital under better terms in the future. Further explanation was offered by Tinic (1988), who argued that underpricing occurs because the issuing

¹ Informed investors consist of investment bankers and the issuing companies, while uninformed investors are generally the individual investors subscribing to the IPOs.

firms want to avoid lawsuits by unhappy investors who are less likely to file lawsuits when new issues are underpriced.

1.2 The Needs and Importance of IPOs

In order to raise funds for business operations or expansions, companies have several mechanisms such as loans, retained earnings and new issues to choose from. Some companies prefer to raise funds by offering new issues in the stock exchange. Among the commonly cited reasons why companies seek listing on the stock exchange are as follows: (i) to raise funds for business operations and expansions, (ii) to obtain listing and quotation on the KLSE, (iii) to give an opportunity for the general public, employees and directors to participate in company's growth and (iv) to comply with the National Development Policy (NDP) by providing an opportunity for Bumiputra investors and institutions approved by Ministry of International Trade and Industry (MITI) to participate in the equity of the company

1.3 The IPO Process in Malaysia

The process of initial public offering is generally the same in any primary market. In Malaysia, any public company, fulfilling the requirements may apply for listing by (i) Public Issue of new shares, (ii) Offer for Sale of existing shares, (iii) Placements, and (iv) Tenders. However, most IPOs involve only public issues and offer for sale. Among the important pre-listing requirements are minimum paid-up capital of RM 60 million (RM 40 million for Second Board), aggregate profit of RM 25 million in the last 3 to 5 years, good financial liquidity, and settlement of all debts owing to the directors. Once a company fulfills the basic requirements, a merchant bank (or a syndicate of merchant banks) will be appointed as the issue's adviser-cum-underwriter. The adviser-cum-underwriter exercises due-diligence analysis of the issues, forecasts the company's profitability, prepares the proposal, and lodges application for listing (with all the facts and figures) with the Securities Commission (SC).²

After taking into consideration the management team; product lines; conflict of interest between directors, underwriters, and other shareholders; business risks and overall contribution to national economic growth, the Securities Commissions determines the suitability of listing based on the facts and figures provided in the application. Once the Securities Commissions is satisfied with the requirements, an offer price is determined and official approval is given to the company for the floatation of the shares.

² Applications may also need to be submitted to the Ministry of International Trade and Industry (MITI) and Foreign Investment Committee (FIC) to obtain official clearance in specific cases.

After obtaining approval for the IPOs the underwriter/issuer makes a press announcement, indicating the approved offer price, and takes the necessary action to float the company shares. The underwriter/issuer also prepares the final prospectus for submission to the Securities Commissions and KLSE, and concentrates on other conditions, subject to the requirements by the Securities Commissions. Public investors are normally invited to apply for new shares a few months before listing. The investors lodge their applications along with full payment. Generally, during good market conditions large over-subscription is common and balloting takes place on the basis agreed by the underwriter, issuer, and the Securities Commissions. The successful applicants are allotted³ shares on or before the listing day, while refund cheques are sent to the unsuccessful and partially successful applicants, usually one week before the listing.

³ Under the Malaysian law, at least 30 percent of the total issuing shares must be set aside for Bumiputera investors (Malay and indigenous people), the first ballot is conducted for this 30 percent of shares. The unsuccessful Bumiputera applications are included in the second balloting for the remaining 70 percent of shares, which are balloted among all the Malaysian citizens including Bumiputeras.

1.4 Methods of New Issues

New issues are the sale of company shares or equity to investors. New issues market consists of offer of shares to the public from private firms and government-linked privatised companies floated on the KLSE. Basically, there are several types of new issues in Malaysia as stated below:

1) Public Issues

This is the most common method of issuing new shares. The company will create new issues for sale to the public. To be listed in the Exchange, the company needs to first obtain approval from the Securities Commission. The issue must be underwritten by merchant's bankers and one of the two issuing houses.

2) Offer for Sale

Offer for Sale is an invitation to the public to buy the shares of new issue from the issuing house to whom the issues has been sold outright by the company concerned. The document whereby the invitation is made is deemed to be a prospectus issued by the company and is subject to all the requirements of the Companies Act. The issuing house, which is sponsoring the offer, may be remunerated, wholly or in part, by the difference between the price, which the company and/ or the vendors receive, and the price at which the shares are offered to the public. In other words, Offer for Sale can be considered as a block of shares belonging to the existing shareholders that is offered for sale to the public.

3) Hybrid of Public Issues and Offer for Sale.

This type of issue is a combination of Public Issue and Offer for Sale. The company uses both types of issues in order to be listed in the stock exchange. Funds raised from Public Issues normally goes to the company and funds raised from Offer for Sale goes to the existing shareholders.

4) Private Placements

This is the selling of shares by a company to a predetermined buyer, often without any intermediary of a stockbroker. Shares are not generally offered to the public but are placed to a group of large institutional investors. Essentially, it allows the directors of a company to influence the selection of its shareholders. In Malaysia, they account to only 5-10 percent of funds raised in the stock market and are only permitted in limited cases.

5) Special Issues

Only Bumiputra institutions and individuals are eligible for this type of issue. A listed company would give a special issues of shares at a price lower than the market price to Bumiputra institutions and individuals. The Securities Commission sanctions the share price while Ministry of International Trade and Industry (MITI) decides the allotment of these shares.

For the purpose of this study, only performance of new issues arising from method 1 (Public Issues), 2 (Offer for Sale) and 3 (Hybrid of Public Issues and

Offer for Sale) will be analysed because most of the companies in the KLSE float their shares via these three methods.

1.5 Listing Requirements

New issues can be listed either on the Main Board or the Second Board based on the listing requirements. Generally the companies must have a good track record and healthy financial conditions. The Second Board companies are relatively smaller than the Main Board companies. Table 1.0 illustrates the main differences of listing requirements between the Main Board and the Second Board companies.

Table 1.0 KLSE Listing Requirements

Requirements	Main Board		Second Board	
Minimum paid-up capital	60 million		40 million	
Profit track record of 3 or 5 financial years	An aggregate after-tax profit of not less than RM 30 million, the minimum after-tax profit for the most recent year should be RM8 million.		An aggregate after-tax profit of not less than RM 12 million, the minimum after-tax profit for the most recent year should be RM4 million.	
Profit Track Record	Option 1	Option 2	Option 1	Option 2
Profit record	3 years	5 years	3 years	5 years
Aggregate after-tax profit	RM 30 mil	RM30 mil	RM12 mil	RM 12 mil
Min after-tax profit for the most recent years	RM8 mil	RM8 mil	RM4 mil	RM4 mil
Prospectus	Must advertise the full prospectus		Advertise only a summary of the prospectus	

Source: KLSE Information Book